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Supreme Court, U.S.
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No. 96-672

In The

Supreme Court of the United States

October Term, 1996

In the Matter of SOUTHMARK CORPORATION,

Debtor.

SCHULTE ROTH & ZABEL,

Petitioner,

v.

SOUTHMARK CORPORATION,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTION PRESENTED

Was a corporation's prepetition payment of dissident shareholders' attorneys' fees and expenses in settlement of litigation in which the shareholders had sought recovery of such fees and expenses made on account of "an antecedent debt owed by the debtor" under section 547(b)(2) of the Bankruptcy Code?

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RESPONDENT'S BRIEF IN OPPOSITION

SOUTHMARK CORPORATION ("Southmark"), Respondent, files this its Brief in Opposition, asking this Court to deny Schulte, Roth & Zabel's Petition for Writ of Certiorari (the "Petition") to review the judgment of the United States Court of Appeals for the Fifth Circuit filed on July 2, 1996. In support of this Request, Southmark respectfully shows the Court as follows:

PROVISIONS OF LAW INVOLVED

11 U.S.C. § 547(b) (section 547 of the Bankruptcy Code) (emphasis on relevant section of statute)

§ 547. **Preferences**

* * *

(b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property –

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made –

(a) on or within ninety (90) days before the date of the filing of the petition; or

(b) between ninety (90) days and one (1) year before the date of the filing

of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if –

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 101(5) and (12) (sections 101(5) and (12) of the Bankruptcy Code)

§ 101. **Definitions**

(5) **"claim"** means –

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured;

* * *

(12) **"debt"** means liability on a claim; . . . .

STATEMENT OF THE CASE

Petitioner's description of the procedural history of this case is accurate, with one qualification. The bankruptcy court's summary judgment order of April 5, 1993 was not "interlocutory at the time it was rendered," as Petitioner described it, but rather was expressly made final by the bankruptcy court pursuant to Fed. R. Civ. P. 54(b). *See* summary judgment order ¶ 4, Appendix A-48.[1]

BACKGROUND FACTS

Southmark generally agrees with the statement of background facts prepared by Schulte, Roth & Zabel ("Petitioner") in this matter. However, there are a few omissions or misstatements which may be material to this Court's determination.

Petitioner characterizes the Parks Group's[2] demands for recovery of its reasonable attorneys' fees and disbursements in three lawsuits as a "boilerplate prayer for relief." Burton Lehman, the Parks Group's lead attorney in the prepetition lawsuits and a partner in the Petitioner

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[1] All references to "Appendix" refer to that contained in Petitioner's Brief.

[2] Unless otherwise defined in this brief, capitalized terms have the same meaning ascribed to them in Petitioner's Brief.

firm, testified at his deposition in the bankruptcy court that this "boilerplate" was not intended to have a lesser significance than any other portion of its pleadings.[3] Petitioner's principal litigator in the relevant litigation, Irwin Sugarman, also testified in his deposition that the attorneys' fee demand had a good faith basis.[4]

Petitioner adequately describes the relief sought in the proxy-related lawsuits, but omits a description of the underlying allegations of wrongdoing on Southmark's part. The Parks Group alleged, among other things, that Southmark had distributed a false and misleading proxy statement in violation of the Securities Exchange Act of 1934 and Rule 14a-9, and had breached its fiduciary duties to its shareholders by adopting a "poison pill" in January, 1989 in order to entrench existing management, had improperly arrogated certain powers to its board of directors, failed to timely hold an annual meeting of shareholders and subjected itself to criminal and monetary penalties by violating the Savings and Loan Holding Company Act.[5]

The May 24, 1989 settlement agreement between the Parks Group and Southmark was reached only a few days before a court-mandated annual meeting of Southmark's shareholders. Petitioners' own proxy solicitation materials recognized that Southmark was then in a state of "financial crisis."[6] Southmark had itself incurred at least

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[3] Rec. 0177a (summary judgment exhibits volume).

[4] Rec. 0358a (summary judgment exhibits volume).

[5] Rec. 0206-0210 (summary judgment exhibits volume).

[6] Rec. v. 4: 0113.

$4 million in legal fees and expenses in the Parks Group litigation and proxy fight by this time.[7] The $3.3 million transfer represented the Parks Group's estimate of its attorneys' fees and other disbursements incurred in the lawsuits and proxy contest. The Parks Group subsequently determined that it was owed an additional $441,732.38 and filed a proof of claim in Southmark's bankruptcy case in that amount.[8]

Southmark emerged from bankruptcy in August, 1990 under a confirmed plan with new management and a mandate to liquidate its assets for the benefit of its former creditors, now its shareholders. Under Southmark's plan, the company's board of directors was reconstituted by its new shareholders.

Finally, Petitioner's statement of facts mischaracterizes the Fifth Circuit's conclusion in this case. The Fifth Circuit did not hold that "a debt can be owed before it is incurred (that is, before the contingency that triggers liability takes place)," as Petitioner suggests.[9] Rather, the court below held that "a 'debt' of Southmark . . . existed for [the Parks Group's] expenditures prior to the execution of the [Settlement] Agreement." *Southmark Corp. v Schulte, Roth & Zabel (In re Southmark Corp.)*, 88 F.3d 311, 317 (5th Cir. 1996), Appendix A-14.

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[7] Rec. 0328 (summary judgment exhibits volume).

[8] Rec. v. 6: 0515.

[9] Petitioner's Brief 8.

REASONS FOR DENYING THE PETITION

SUMMARY

The Fifth Circuit properly rejected Petitioner's argument that a "debt" arose out of thin air when the prepetition settlement agreement was reached in this matter. Settlement agreements which terminate litigation resolve preexisting claims against, and liabilities of, the respective parties and typically produce a release of those preexisting claims and liabilities. The present case was no exception.

In its effort to secure a writ from this Court, Petitioner has mischaracterized the issue for review by repeatedly asserting that the Parks Group held only a "contingent claim" against Southmark prior to the $3.3 million settlement payment. A claim for attorneys' fees arising from a breach of duty to shareholders on the part of a public corporation may be disputed and unliquidated, but it is no more "contingent" than the claim of any other injured plaintiff prior to judgment. Nor did the Parks Group's claim against Southmark arise by contract. Thus, the Court's review of this case will not resolve any perceived uncertainty among the courts of appeals about the point at which a contingent, executory contract gives rise to a "debt" under the Bankruptcy Code.[10]

This Court has consistently held that the meanings of "claim" and "debt" in bankruptcy are coextensive, relying on the plain statutory language of the Code. These decisions uphold Congress' express intention that "all

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[10] 11 U.S.C. § 101 et seq. (hereinafter, the "Code").

legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case."[11] The Code long ago abolished the distinction between provable and nonprovable claims, a reform which Petitioner effectively invites this Court to reconsider. Petitioner has failed to demonstrate any disagreement among the courts of appeals that a disputed, unliquidated claim for attorneys' fees and disbursements creates a corresponding disputed, unliquidated debt owed by the debtor, nor has Petitioner made any other showing of appropriate grounds for review under Rule 10.

A. UNDER ESTABLISHED PRECEDENT OF THIS COURT, THE PARKS GROUP'S CLAIM GAVE RISE TO A CORRESPONDING DEBT OF SOUTHMARK.

Petitioner concedes that the Parks Group had a claim against Southmark prior to the settlement agreement which produced the $3.3 million transfer. *See, e.g.*, Petitioner's Brief 9, 14. All of the courts below likewise determined that the Parks Group's litigation demands for reimbursement of its attorneys' fees and disbursements constituted a "claim" within the broad definition contained in the Code.[12] *See* 11 U.S.C. § 101(5). However, Petitioner's contention that a creditor may somehow hold a claim against the debtor without any corresponding

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[11] H.R. Rep. No. 595, 95th Cong., 2d Sess. 309 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6266; S. Rep. No. 989, 95th Cong., 2d Sess. 22 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5808.

[12] Appendix 13, 27, 44.

debt to the creditor flies in the face of established precedent of this Court.

In *Pennsylvania Dep't. of Public Welfare v. Davenport*, 495 U.S. 640 (1990), this Court confronted the issue whether restitution obligations amounted to dischargeable debts in bankruptcy. Examining statutory definitions of "claim" and "debt" ("liability on a claim"), the Court noted the "expansive language" in both definitions, "reflect[ing] Congress' broad rather than restrictive view of the class of obligations that qualify as a 'claim' giving rise to a 'debt.' " *Id.* at 558. The definition of debt, the Court concluded, "reveals Congress' intent that the meanings of 'debt' and 'claim' be *coextensive.*" *Id.* (emphasis added). The *Davenport* decision was expressly rooted in legislative history describing the definition of "claim" as the "broadest possible" and noting that the Code "contemplates that all legal obligations of debtor . . . will be able to be dealt with in the bankruptcy case." *Id.* (*citing* H.R. Rep. No. 95-595, 2d Sess. 309, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6266 and S.Rep. No. 95-989, 2d Sess. 22, *reprinted in* 1978 U.S.C.C.A.N. 5808). The Court further observed in *Davenport* that Congress had likewise adopted the "broadest possible" definition of debt in 11 U.S.C. § 101(11). *Id.* at 563-64.[13]

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[13] "The terms 'debt' and 'claim' are synonymous and refer to a single obligation as seen from the point of view of the debtor and creditor; a debtor has 'debts' and a creditor has 'claims.' " *In re Jordan*, 166 B.R. 201, 202 (Bankr. D. Me. 1994). *See also* legislative history to 11 U.S.C. § 101(11), S. Rep. No. 989, 95th Cong., 2d Sess. 23 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5809 ("The terms 'debt' and 'claim' are co-extensive: a creditor has a 'claim' against the debtor; the debtor owes a 'debt' to the creditor").

The Court reaffirmed the coextensive nature of claims and debts in *Johnson v. Home State Bank*, 501 U.S. 78 (1991). In the context of determining the extent of a chapter 13 discharge, the Court noted:

> A bankruptcy discharge extinguishes "the personal liability of the debtor with respect to any *debt*." 11 U.S.C. § 524(a)(1) (emphasis added). As we explained in *Davenport*, "debt," which is defined under the Code as "liability on a claim," 11 U.S.C. § 101(12) (1988 Ed., Supp. 3), has a meaning coextensive with that of "claim" as defined in § 101(5). [*citing Davenport*]. Hence, a discharge under the Code extinguishes the debtor's personal liability on his creditor's claims.

Id. at 85, n.5.

Johnson makes an important point. The broad definition of "debt" is integral to the workings of the Code, going to the ultimate issue of the extent of a discharge in bankruptcy. Under any narrower definition of "debt," creditors' claims which fail to qualify as debts would survive bankruptcy because only "debts" are discharged under the Code's provisions. *See* 11 U.S.C. §§ 727(b), 1141(d)(1)(A), 1228(a) and 1328(b).

Petitioner would have this Court hold that certain claims do not rise to the level of debts, at least in the preference context. However, "[t]he Code defines 'claim' and 'debt' for the purposes of the entire title, not individual sections." *Lindsey, Stephenson & Lindsey v. Federal Deposit Ins. Corp. (In re Lindsey, Stephenson & Lindsey)*, 995 F.2d 626, 628 (5th Cir.1994), *cert. denied*, 114 S. Ct. 1053 (1994). To accept Petitioner's argument, therefore,

requires this Court to reach either of two singularly unattractive results. Either a "debt" has a narrower definition for preference purposes than elsewhere in the Code, or the definition of "debt" generally employed throughout the Code is more limited than previously thought. There is neither any textual basis in the Code nor any expression of congressional intent for the former result. The latter result would wreak havoc in the interpretation and application of numerous Code provisions which rely upon a consistently broad definition of "debt." In fact, Congress intentionally abandoned the pre-Code distinction under which only "provable" claims could qualify as debts in bankruptcy, while "nonprovable" claims were left unresolved by the debtor's bankruptcy case. *See* 2 COLLIER ON BANKRUPTCY ¶ 101.05 at 101-56 (15th ed. 1996); *Hoenig v. Hoffman (In re Hoffman)*, 33 B.R. 937, 940 (Bankr. W.D. Okla. 1983).

Nor did Congress' use of the phrase "*liability* on a claim" in defining "debt" signal a more constricted definition than that for "claim," as Petitioner supposes. "Liability" is defined in the leading law dictionary as follows:

> The word is a broad legal term of the most comprehensive significance, including almost every character of hazard or responsibility, absolute, contingent or likely. It has been defined to mean: all character of debt and obligations; . . . condition of being actually or potentially subject to an obligation; . . .

BLACKS LAW DICTIONARY 914 (6th ed. 1990). *See New York Credit Adjustment Bureau, Inc. v. Just-in Materials, Designs, Ltd. (In re Vasu Fabrics, Inc.)*, 39 B.R. 513, 517 (Bankr. S.D.N.Y. 1984) (rejecting preference defendants' argument

that the definition of debt "carries with it the requirement that the debtor's obligation be an established or conceded one, not merely one asserted against it;" citing the BLACKS definition); *accord Energy Cooperative, Inc. v. Socap Int'l, Ltd. (In re Energy Cooperative, Inc.)*, 832 F.2d 997, 1001-02 (7th Cir. 1987) ("when a creditor has a claim against a debtor – even if the claim is unliquidated, unfixed or contingent – the debtor has incurred a debt to the creditor.").

The Fifth Circuit determined in this case that the Parks Group's litigation demands for reimbursement of its attorneys' fees and disbursements created not only a claim but also a debt in Southmark's bankruptcy case for all purposes, including that of preference recovery. It carefully premised its decision upon the plain meaning of the statute, the ample legislative history and this Court's above-cited precedent. There is simply no dissent among the courts of appeals about the coextensive nature and functional equivalence of a "claim" and a "debt," nor has Petitioner cited this Court to any disagreement about this central proposition. Thus, the grant of a writ of certiorari in this case would not clarify the law nor resolve any issue of public importance, but would yield only a reexamination and reapplication of settled bankruptcy law.

B. THIS CASE WILL NOT RESOLVE ANY UNCERTAINTY REGARDING DEBTS ARISING FROM CONTINGENT OR EXECUTORY CONTRACTS.

Petitioner invites this Court to review this case on the basis that it will settle the question whether the existence

of a claim *always* creates a debt.[14] Petitioner insists that there is a "confusing and conflicting body of case law" regarding when a contingent claim gives rise to a debt in bankruptcy.[15] In its effort to show a conflict among the courts of appeals, however, Petitioner has managed to cite only a string of cases involving *contingent contract* claims. This Court's review of this case would not likely resolve any of the asserted conflicts because it involves neither a contingent claim nor one that arises by contract.

Petitioner presents this Court with a comparison of preference decisions which have attempted to fix the date upon which a debt arose in order to determine if it was antecedent at the time of the transfer. It is significant that in each such case, there was a *contract* between the parties with payment due upon the satisfaction of some contingent event such as passage of time or performance. *Compare, e.g., Upstairs Gallery, Inc. v. Macklowe West Dev. Co., L.P. (In re Upstairs Gallery, Inc.)*, 167 B.R. 915 (Bankr. App. 9th Cir. 1994) (payment upon lease termination was made on account of debt incurred on date lease was executed) *with Southmark Corp. v. Marley (In re Southmark Corp.)*, 62 F.3d 104 (5th Cir. 1995) (severance payment was made on account of debt arising at time of breach of employment

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[14] Petitioner's expansive framing of the issue in this case is not particularly illuminating. Even if review of this matter is granted, this Court would most likely exercise its customary restraint and decide only the issue before it. That issue is simply whether the Parks Group's claim in *this* case – and claims with like characteristics – constitute debts for purposes of the Code, not whether every claim always constitutes a debt under all circumstances.

[15] Petitioner's Brief 8.

agreement, not upon execution of employment agreement), *cert. denied*, 116 S. Ct. 815 (1996); *Nolden v. Van Dyke Seed Co. (In re Gold Coast Seed Co.)*, 751 F.2d 1118 (9th Cir. 1985) (debt incurred at time seeds were delivered and debtor became liable to pay for them, as opposed to date upon which executory contract for their delivery was executed); *Iowa Premium Serv. Co., Inc. v. First Nat. Bank in St. Louis (Iowa Premium Serv. Co.)*, 695 F.2d 1109 (8th Cir. en banc 1982) (debt for interest payments on a note incurred when money used, not when note signed). The issue before those courts, then, was whether the debt on account of which the preferential transfer was made arose (1) at the time the contract or instrument was executed by the parties, or (2) at the time the debtor breached the contract or the contingent event occurred.[16]

This central issue in the contingent contract cases cited by Petitioner does not present itself in the case at bar. Rather, the litigation between the Parks Group and Southmark arose from alleged breaches of legal or tort duties, not duties arising out of any contract. The Parks Group sued Southmark for numerous breaches of fiduciary duty to its shareholders beginning in January, 1989, including its adoption of a "poison pill" to thwart a hostile takeover and entrench existing management, use of a proxy statement containing false and misleading

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[16] Significantly, none of these decisions hold that a claim may exist for some period of time independently of any corresponding debt. Rather, they address the time at which the creditor's claim *and* the debtor's corresponding debt simultaneously arise. *See, e.g., Marley*, 62 F.3d at 106; *Nolden*, 751 F.2d at 1119; *Iowa Premium*, 695 F.2d at 1111; *Upstairs Gallery*, 167 B.R. at 917-18.

statements and omissions of material fact, the failure to timely convene an annual meeting, and violation of other federal statutes subjecting Southmark to penalties, among others.[17] The Parks Group incurred enormous proxy and litigation expenses to expose and rectify the wrongdoing of Southmark's prepetition management, and continuously sought recovery of its attorneys' fees and disbursements from courts of competent jurisdiction. By contrast, a party to a contract ordinarily cannot bring suit to recover under its provisions unless and until the other party has breached the contract, a substantial point of distinction between the present case and those cited by Petitioner.

Petitioner's classification of the Parks Group's claim against Southmark as "contingent" is a misnomer. Contingencies are creatures of contract, not torts. BLACKS LAW DICTIONARY defines a "contingent debt" as "[a] debt in bankruptcy which may be proved and allowed *and which arises out of contract.*" *Id.* at 321 (emphasis added). *See also In re McGovern*, 122 B.R. 712, 716 (Bankr. N.D. Ind. 1989) ("If the debtor's obligation to a creditor has already come into existence and is capable of being enforced the claim is noncontingent; references to tort claims as contingent "are the result of careless usage and the failure to properly distinguish between concepts of contingency and liquidation").

In cases involving preferential payments on account of debts arising from torts or other breaches of legal

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[17] *See* Counterclaim of the Parks Group at 8-12 (Rec. 0206-0210 (summary judgment exhibits volume)).

duties, courts uniformly look to the time of the debtor's misconduct (or breach of duty) to determine when the debt was incurred. *See, e.g., Bioplasty, Inc. v. First Trust Nat. Ass'n (In re Bioplasty, Inc.)*, 155 B.R. 495, 499 (Bankr. D Minn. 1993) (preferential payment by debtor to settle claims for securities violations, misrepresentations and other torts); *Imperial Corp. of America v. Milberg, Weiss, Bershad, Specthrie & Lerach (In re Imperial Corp. of America)*, 144 B.R. 115 (Bankr. S.D. Cal. 1992) (payments to plaintiff's attorneys in securities class action in settlement of suit); *Vasu*, 39 B.R. at 517 (payments in settlement of claims for copyright infringement, unfair trade practices and unfair competition).

Petitioner apparently concedes that a debt necessarily arises at the time of the debtor's breach. *See* Petitioner's Brief 23 (hypothetical). Even in the contingent contract cases cited by Petitioner, it is clear that a debt arises for preference purposes *no later than* the time of the debtor's breach. *See, e.g., Marley*, 62 F.3d at 105.

Before the $3.3 million transfer and settlement in the present case, The Parks Group had identified numerous breaches of fiduciary duty by Southmark to its shareholders. The Parks Group commenced a proxy fight and litigation against Southmark in several courts, seeking corrective, injunctive relief, exposing proxy misstatements by Southmark's incumbent management and forcing the company to call a shareholder's meeting. This Court established the entitlement of shareholders to recover their attorneys' fees from a corporate defendant in litigation involving false or misleading proxy statements – even though litigation may never produce any

monetary recovery – in *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 391-92 (1970).[18]

A plaintiff establishes a common benefit sufficient to recover its attorneys' fees under *Mills* if it is able to show that its efforts "informed corporate suffrage" by exposing material proxy misstatements. *Id.* at 396. The right to recover reasonable attorneys' fees and expenses continues regardless of whether the plaintiff's civil action is mooted by corrective action on the part of the corporate defendant. *See Maher v. Zapata Corp.*, 714 F.2d 436, 457-58, n.38 (5th Cir. 1983) (shareholders' derivative action; plaintiff's suit was at least a contributing factor in several beneficial changes by corporation and therefore "plaintiff was *entitled* to reimbursement for attorneys' fees and costs"); *Lewis v. Anderson*, 692 F.2d 1267, 1270-71 (9th Cir. 1982) (despite voluntary dismissal of derivative claims, plaintiff could recover attorneys' fees for benefit to corporate shareholders); *Ramey v. Cincinnati Enquirer, Inc.*, 508 F.2d 1188, 1194-96 (6th Cir. 1974) (plaintiffs in derivative and proxy suit were entitled to recover attorneys'

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[18] In *Mills*, the Court concluded:

> The fact that this suit has not yet produced, and may never produce, a monetary recovery from which the fees could be paid does not preclude an award based on this rationale [of unjust enrichment]. Although the earliest cases recognizing a right to reimbursement involved litigation that had produced or preserved a "common fund" for the benefit of a group, nothing in the cases indicates that the suit must actually bring money into the court as a prerequisite to the court's power to order reimbursement of expenses.

396 U.S. at 392.

fees, despite lack of any monetary recovery by corporation, the impossibility of assigning value to the benefit, or the prejudgment action of the corporation to moot their suit), *cert. denied*, 422 U.S. 1048 (1975). The lead lawyer employed by Petitioner in its representation of the Parks Group testified in his deposition that it was both his and the Parks Group's expectation that they were conferring a benefit upon Southmark shareholders by virtue of the proxy contest.[19]

Petitioner's speculation that "the only way to show substantial benefit [on the part of the dissident shareholders] is to succeed in taking over the company" is simply unfounded. *See* Petitioner's Brief 15, n.15. Had Southmark filed bankruptcy before settling with the Parks Group, the Parks Group clearly would have been able to assert a claim in Southmark's bankruptcy case, with a corresponding debt on Southmark's part. *See In re Hadden*, 57 B.R. 187, 189 (Bankr. W.D. Wis. 1986) (even though claim for recovery of attorneys' fees from debtor was unadjudicated and discretionary at time of bankruptcy, it was nonetheless dischargeable as a debt).

The contract cases cited by Petitioner to justify review in this case are inapposite for another reason. Between the time of its execution and the time of breach, a contract is ordinarily considered executory, with material performance due on the part of both parties. *See Nat. Labor Relations Board v. Bildisco and Bildisco*, 465 U.S. 513, 522, n.6 (1984). Executory contracts are subject to a

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[19] *See* deposition transcript of Burton Lehman (Rec. 0172a (summary judgment exhibits volume)).

unique set of rules in bankruptcy, whereby the trustee may ultimately decide to assume a contract as a postpetition obligation of the estate, or to reject it, creating only a prepetition claim against the estate. *See* 11 U.S.C. § 365; *In re Norquist*, 43 B.R. 224, 225 (Bankr. E.D. Wash. 1984) (discussing purposes of § 365). In its *Marley* decision, the Fifth Circuit relied upon the provisions of section 365 in concluding that "a party to an executory contract has a claim against the debtor only when the debtor has rejected the contract." 62 F.3d at 106; *see also In re Jolly*, 574 F.2d 349, 351 (6th Cir. 1978) (other party to an executory contract has no claim until the debtor rejects the contract), *cert. denied*, 439 U.S. 929 (1978). Petitioner's hypothetical about an executory contract between "Betty Jo" and "Bubba" thus misses the mark because it fails to account for the effects of section 365.[20] Therefore, review of the present case could not fully resolve any uncertainty in the law as to when debts arise from breached executory contracts since the latter situation involves unique substantive considerations.

Courts have uniformly rejected the ultimate argument which Petitioner makes in this case: that there was no preference because no debt arose until Southmark agreed to settle the litigation claims against it. Until that time, Petitioner argues, there were disputed or contingent claims, but no debt because no judgment had been rendered nor liability conceded. *Contra Energy Cooperative,*

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[20] Petitioner's hypothetical is further misleading because Petitioner too quickly assumes that a contingent claim necessarily arises at the time an executory contract is made, in spite of authority to the contrary. *See Jolly*, 574 F.2d. at 351.

832 F.2d at 1003; *Bioplasty*, 155 B.R. at 499; *Vasu*, 39 B.R. at 517. "A later compromise of a claim is of no effect as to when a debt arose." *In re Bob Grissett Golf Shoppes, Inc.*, 44 B.R. 156, 159 (Bankr. E.D. Va. 1984). The Fifth Circuit properly refused to adopt the false baseline for the creation of the debt suggested by Petitioner. Permitting preferential transferees to manipulate the antecedent debt element by repackaging a disputed debt as a new settlement obligation would seriously undermine the use of the preference remedy.

C. PETITIONER'S ARGUMENT THAT AN ANTECEDENT DEBT IS ONLY "OWED" IF A DEBTOR IS LEGALLY OBLIGATED TO PAY FINDS NO STATUTORY OR JUDICIAL SUPPORT.

The relevant element of a preference claim requires that the transfer be made "for or on account of an antecedent debt owed by the debtor before such transfer was made . . . " 11 U.S.C. § 547(b)(2). Petitioner insists that the Fifth Circuit erred by failing to read the word "owed" in the statute as imposing an additional requirement that the debtor be "legally obligated" to pay the debt. Petitioner's Brief 26-27. The Fifth Circuit aptly described this argument as "specious" inasmuch as it finds no support in the language of the Code, its legislative history or in any case law.[21] The novel interpretation advanced by Petitioner would effectively limit preference liability to only those creditors to whom absolute, incontestable obligations are owed.

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[21] 88 F.3d at 317, Appendix 16.

No preference decision has ever embraced Petitioner's narrow reading of section 547(b)(2). Petitioner is able to muster only *In re Brennan*, 187 B.R. 135 (Bankr. D. N.J. 1995) in support of this proposition. Petitioner's Brief 20, n.20. However, *Brennan* only addressed whether an attorney qualified as a disinterested professional person under section 327(a) of the Code even though, among other things, he might have received a preference. Although the court suggested in dicta that the word "owed" should be construed to add some meaning to the prior term "antecedent debt," it hastened to add that its conclusion was without prejudice to the right of any party challenging the transfer to argue for a different conclusion of law since none of the parties had argued or briefed the antecedent debt issue. *Id.* at 153. In contrast, the numerous preference decisions permitting recovery of preferential transfers made on account of disputed or unliquidated debts attest to the unsoundness of this proposition. *See, e.g., Energy Cooperative*, 832 F.2d at 1002; *Bioplasty*, 155 B.R. at 499; *Vasu*, 39 B.R. at 518 ("Had Congress wished to exclude payment of undisputed, unliquidated, or contingent claims from the scope of Code § 547(b), it could have done so.").

The use of "owed" in section 547(b)(2) is more consistent with the commonly understood meaning of this word: to bear or to be indebted to.[22] An examination of Congress' use of the word "owed" in connection with

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[22] *See* WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY 843 (1984) (defining "owe" to include the following: "to have or bear . . . to be under obligation to pay or repay . . . to be indebted to . . . to be in debt").

debts elsewhere in the Code and its legislative history confirms this interpretation. For example, in the legislative history to section 101, the drafters noted:

> The terms "debt" and "claim" are co-extensive: a creditor has a "claim" against the debtor; the debtor *owes* a "debt" to the creditor.

S. Rep. No. 989, 95th Cong., 2d Sess. 23, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5809 (1978) (emphasis added). Elsewhere, in section 523(a)(3), a debt which the debtor fails to list on its schedules to the "creditor to whom such debt is *owed*" is non-dischargeable, even though the debt owed may be an unliquidated tort claim for fraud or for willful and malicious injury by the debtor. *See* 11 U.S.C. § 523(a)(3)(B), (4), (6) (emphasis added).

A natural reading of section 547(b)(2) thus indicates that Congress was simply clarifying that, in order for a preference to occur, the payment cannot be on account of another party's antecedent debt, but only that of the debtor. This reading comports well with Congress' expressed purposes in enacting the preference statute: "to deter creditors from dismembering the debtor during his slide into bankruptcy" and to promote equal distribution among the bankrupt's creditors. *See Energy Cooperative*, 832 F.2d at 1002-3, *citing* H.R. Rep. No. 595, 95th Cong., 2d Sess. 309, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6139.[23]

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[23] The Bankruptcy Review Commission report cited by Petitioner is not helpful in this matter since its proposed language following the term "antecedent debt" was entirely discarded by Congress in favor of the final version and does not appear in the relevant House and Senate bills. *Compare* REPORT OF THE COMMISSION IN THE BANKRUPTCY LAWS OF THE UNITED STATES,

Petitioner's interpretation confounds, rather than advances, these expressed policies of Congress under the Code by permitting creditors holding disputed, unliquidated or contingent claims to dismember a debtor with impunity, to the prejudice of creditors generally.[24]

CONCLUSION

Although this case presents a somewhat unusual fact pattern, it offers no material distinction that would remove it from the application of well established Code principles. The Parks Group's claims against Southmark – whether they are characterized as disputed, unliquidated, or even contingent – nonetheless constituted "debts" from their very inception. The plain language of the Code and this Court's precedent establish that a claim and a debt are, by definition, mirror images of one another, and one cannot be artificially manipulated without doing injury to the fabric of the Code.

The only uncertainty in the law concerning bankruptcy debts which Petitioner has been able to identify arises wholly in the context of contingent contract claims.

H.R. Doc. No. 93-137 (1973) *with* H.R. Rep. No. 595, 2d Sess. 372 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6328; S.Rep. No. 989, 95th Cong., 2d Sess. 87 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5873. *See* Petitioner's Brief 28.

[24] Congress expressed concern that certain provisions in the pre-Code preference statute "defeat[ed] the policy of the preference statute by limiting recoveries to only the most egregious cases," prompting a number of amendments under the Code. H.R. Rep. No. 595, *supra*, at 178.

Review of this case would do little to resolve that uncertainty, however, since executory contracts trigger unique bankruptcy issues. Nor will this case answer the question whether a contract debt arises at the time a contract is executed or when some contingency is later satisfied. Moreover, in the eighteen (18) years since the Code's enactment, no court has embraced Petitioner's novel argument that the word "owed" in section 547(b)(2) significantly limits the class of debts which may give rise to preferences.

This case involves only a reaffirmation of settled law to new facts and is therefore not appropriate for review under Rule 10 standards. Petitioner's request for a writ of certiorari should therefore be denied.

Respectfully submitted,

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